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¶1. (U) The following is a periodic economic update for Ecuador that reports notable developments that were not reported by individual cables during the December 2009-January 2010 timeframe. This document is sensitive but unclassified. It should not be disseminated outside of USG channels and should not be posted on the internet.

Highlights

-- Suspension of electricity rationing

-- Ecuador retires more than $50 million in global bonds

-- Ecuador's balance of payments recovers

-- Balance of payments safeguards to be gradually reduced

-- GoE closes deposit insurance agency

-- Increase in remittances tax entered into force January 1, 2010

Suspension of electricity rationing

¶2. (SBU) On January 20, Ecuador's Minister of Electricity and Renewable Energy, Dr. Miguel Calahorrano Camino, announced the indefinite suspension of electricity rationing. Starting November 5 the GoE resorted to the rationing - scheduled blackouts -- to control demand during semi-drought conditions that greatly reduced hydroelectric output. The GoE has relied on thermoelectric generators and electricity purchases from Colombia and Peru to fill the gap during past dry seasons. However, these measures were insufficient to meet demand this year (see Ref A for additional detail). Recent rainfall, rationing, and purchase and rental of

additional generating capacity eventually allowed Ecuador's main reservoir at the Paute dam to fill to a level sufficient to increase hydropower generation. Although this has relieved the need for rationing, the GoE cautions that a return to rationing could be necessary if water levels at the Paute dam again fall too low.

¶3. (SBU) The scheduled blackouts caused inconvenience and major economic losses. While the government reports these losses at $500 million, private sector analysts estimate losses are closer to $1 billion. Small businesses that lacked generators were the hardest hit as blackouts sometimes lasted as many as 5 to 8 daylight hours per day, with the longest blackouts occurring in the coastal regions - and especially highly industrialized Guayaquil. As a consolation, the GoE has announced a 10% and 20% discount on electricity to residential and commercial users respectively for a period of three months beginning February.

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Ecuador retires more than $50 million in global bonds

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¶4. (SBU) On December 30, Ministry of Finance Elsa Viteri announced that Ecuador retired $55 million of 2012 and 2030 global bonds in an operation with Italian holders aimed at buying back debt the government defaulted on in December 2008. According to Minister Viteri, about $190 million in defaulted debt remains outstanding. Background: Ecuador refused to pay $3.2 billion in global bonds in December 2008, claiming there were irregularities in the issuance of the debt in 2000 after the renegotiation of a previous default. Italian investors, for internal regulatory reasons specific to Italy, were unable to participate in the bond repurchase operation held in June 2009, in which the GOE paid 35 cents on each dollar worth of debt. The same price was offered to Italian bondholders who participated in this operation. During the June 2009 buyback, the GoE successfully repurchased $2.9 billion or 91% of the country's 2012 and 2030 global bonds via a modified Dutch auction.

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Ecuador's balance of payments recovers

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¶5. (SBU) Ecuador's balance of payments ran a surplus of $24.6 million for the first nine months of 2009. During this time period, exports fell 37% and imports decreased 21%, compared to the same period in 2008. While the surplus was significantly lower than the $3.05 billion surplus for the first nine months of 2008, it represented a sharp improvement from the first half of 2009. The turnaround reflected the strong surplus in the third quarter of 2009 of $1.94 billion, a marked recovery from deficits of $1.3 billion and $580 million recorded in the first and second quarters of 2009, respectively. This recovery is mainly attributed to the increase in oil export earnings during the second half of 2009, the partial recovery of remittances from abroad during this same period, and the financing received by the GoE from China and the IMF. In addition, the GoE argues that the balance of payments safeguards imposed in January 2009 were a major factor in the reduction of imports in 2009. As a result of these combined factors, both the current account and the capital account reflected surpluses in the third quarter of 2009.

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Balance of payments safeguards to be gradually reduced

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¶6. (SBU) Resolution 533 of Ecuador's Foreign Trade and Investments Council (COMEXI), which was published on January 15, 2010, confirmed the GoE's intention to continue balance of payments safeguard measures beyond the one-year term allowed under WTO rules. The safeguards were originally applied on January 22, 2009. The resolution indicated that the safeguard measures -- ad-valorem and specific tariff surcharges -- would be reduced by 10% effective January 23, 2010. According to local press, President Correa instructed COMEXI to reduce the total tariff surcharges gradually over six months. COMEXI will meet periodically during this six-month period to confirm the rate with which the GoE will reduce the safeguard tariffs.

¶7. (SBU) President Correa has announced in public remarks that the GoE may decide to put in place specific trade restrictions to reduce foreign competition and support local production of sensitive sectors, such as footwear, leather, and textile and apparel industries. Correa claims that these industries face "unfair competition" from countries such as China. However, he and

other GoE officials have provided assurances that the GoE would comply with its WTO commitments in applying these protections.

¶8. (SBU) GoE officials argue that the BoP trade restrictions contributed to the 21%, or $2.75 billion, decline in imports over the first nine months of 2009 (compared to the same period in 2008), and also promoted an increase in sales of local footwear and apparel products. Coordinating Minister for Production Nathalie Cely, who presides over COMEXI, has stated publicly that in addition to the safeguards, the GoE's implementation of different plans to increase the country's competitiveness played a role in reducing imports. Cely justified the gradual reduction of the safeguards as necessary to avoid an "avalanche of imports."

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GoE closes deposit insurance agency

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¶9. (SBU) On December 31, 2009, the GoE closed Ecuador's Agency for Deposits Insurance (AGD), adhering to a deadline demanded by President Correa. The GoE created the AGD in 1998 to insure bank deposits and liquidate the more than 40 financial institutions that went bankrupt during debilitating financial crisis of the late 1990s. In late 2009, Correa, frustrated with the AGD's lack of progress, ordered the Superintendent of Banks to close AGD and complete the liquidation of the 33 banks remaining from the original list of over 40.

¶10. (SBU) The Bank Superintendent accomplished the task of closing down the AGD and 28 of the 33 failed banks by transferring all assets to Ecuador's Central Bank. In total, the Central Bank has received a loan portfolio of about $2 billion and over 6,000 insolvency and bankruptcy cases. It is establishing a special unit to resolve legal and financial issues related to these assets,

collect amounts owed to the failed banks, liquidate assets seized from shareholders, and reimburse deposits to clients. The Bank Superintendent was unable to conclude the liquidation of five of the 33 financial institutions -- Progreso, Filanbanco, Los Andes, Benalcazar and Tecfinsa - but has announced its intention to do so during the first quarter of 2010. In addition, it has announced plans to disclose a list of directors, managers and bankers that caused the failure of these 33 financial entities and losses to third parties, and also warned that it may pursue legal actions against these individuals.

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Increase in remittances tax entered into force January 1, 2010

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¶11. (U) On January 1, 2010, the GoE's latest tax reform bill,

pending since August 2009 and designed to boost revenue and limit dollar outflows, entered into force (Ref B). The law passed by the National Assembly establishes a 12% Value Added Tax (VAT) on newspaper print, a minimum income tax on companies, and a tax on shareholders' dividends. The most controversial element, particularly for multinational companies, is the increase of the tax on outgoing capital flows from 1% to 2%.
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